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SUBJECT: Philippines Turbulent Civair Development

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SENSITIVE BUT UNCLASSIFIED - PROTECT ACCORDINGLY

¶1. (SBU) Summary: Liberalization of civil aviation is crucial to the development of the Philippine economy, particularly by unlocking the potential of Asian tourism into the Philippines. Nevertheless, vested interests have, until recently, kept the GRP from implementing liberal policies. Post is assisting a local coalition in its attempt to crack open the civil aviation sector. End Summary.

The High Price of Protectionism

¶2. (U) With beautiful white sand beaches only a short flight from China, Korea, Taiwan, and other countries with large numbers of potential tourists, the Philippines could be on the verge of a tourism boom. Located centrally in Southeast Asia, the country also would seem to have the potential to serve as a regional transport and logistics hub.

¶3. (SBU) Unfortunately, thus far civil aviation policy in the Philippines has been geared to allowing Philippine Airlines (PAL) to maintain high prices and load factors on heavily-restricted routes. The price of air transportation to and from the Philippines is much higher than for nearby (and, in the case of tourism, competitor) countries. An unpublished study by local economists found that tickets from Shanghai were four times more expensive to Manila than to Kuala Lumpur on a seat/kilometer basis. Prices from Tokyo to Cebu, Philippines were more than double those of tickets to Bali, Indonesia. Although longer flights and market efficiencies may account for some differences, they cannot justify such high differentials.

A Summary History of Liberalization

¶4. (U) The Ramos Administration liberalized domestic civil aviation beginning with the 1995 abolition of the "one airline policy." Several new airlines developed in the mid-1990s as a result. Increased competition lowered prices and increased travel on the major domestic routes.

¶5. (SBU) The closing of U.S. military bases in the early 1990s inspired a Philippine dream of transforming the world-class abandoned infrastructure into an Asian transport and logistics hub. Clark Airport, only 50 miles from Manila, boasts two parallel runways capable of handling the world's largest planes (ref A). FedEx and UPS set up hubs in Clark and nearby Subic Bay. Negotiations that would complement the investments and grant bilateral cargo open skies failed, however, when GRP negotiators speciously declared such air traffic rights unconstitutional in mid-2003 (ref D). Instead, President Arroyo issued Executive Order

253 a few months later without much resistance, unilaterally granting cargo open skies at these airports.

¶6. (SBU) Developing airports fit nicely into the Arroyo Administration's campaign to stimulate economic growth outside the capital region. The Civil Aeronautics Board (CAB) issued Resolution No. 23 in 2005 liberalizing passenger travel at Clark, Subic, and several other "developmental gateways." Airlines were still at the mercy of the CAB, though, and traffic rights could change with a CAB board meeting decision. For example, the CAB disapproved Singaporean carrier Tiger Airways' permits in December 2005 after two months of successful operations, forcing the cancellation of flights and stranding thousands of travelers. Advocates of liberalization took advantage of overreaching by their opponents. President Arroyo ensured a more stable policy environment for Clark by issuing Executive Order (E.O.) 500 in January 2006.

¶7. (U) Unfortunately, there were legal defects in E.O. 500 that required amendment. Advocates of reform say that their modified version was hijacked by the Department of Transportation and Communications and replaced with the E.O. 500A which was signed by Arroyo. This decree, issued in August 2006, severely curtailed the liberal aspects of E.O. 500, removing fifth freedom rights and requiring airlines to be designated carriers. Fifth freedom rights allow more profitable regional routes such as a Singaporean airline flying Macau-Clark-Singapore.

Clark's Civair Tug-of-War

¶8. (SBU) Implementing E.O. 500A, the Civil Aeronautics Board (CAB) has moved to restrict the operations of foreign carriers at Clark. In February 2007, the CAB abruptly limited the Tiger Airways permit to fly from six to three months, forcing Tiger to refund already

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sold tickets and reduce its flights into Clark. The CAB's overreach once again played into the hands of proponents of liberalization. Cabinet level Secretaries bemoaned the "regulatory capture" of the CAB, i.e., the influence of domestic private companies over its decisions. A new order, E.O. 500B, is now in the Presidential Palace awaiting signature. This decree is a perfected version of the original E.O. 500, and thus would reinstate all freedoms except cabotage for both designated and non-designated carriers flying to Clark.

¶9. (SBU) The debate over liberalized civil aviation policies intensified in April as advocates and opponents purchased full-page newspaper ads expressing their views on the proposed E.O. 500B. Philippine carriers struck a nationalistic tone, demanding a strict interpretation of reciprocity, misinforming on the implications of 500B, and again claiming that the decree violates the Constitution (which it does not). Advocates, including local politicians and chambers of commerce, contended that the economic development which would come with lower airfares and more tourists would more than compensate for any damage to the interests of the airlines.

Major Players - Entrenched Interests

¶10. (SBU) The owners of the two major domestic airlines are Chinese-Filipinos Lucio Tan and John Lance Gokongwei, Jr. Lucio Tan, considered one of the foremost cronies of late-President Ferdinand Marcos, began his empire in the scrap metal business before diversifying during the Marcos years into tobacco, alcohol, beverages, hotels, and finance. His holding company purchased Philippine Airlines from the government in 1992. Forbes Magazine listed Tan as the 407th richest person in the world in 2007, with a personal net worth of 2.3 billion dollars. He was considered the 12th richest man in Southeast Asia and the third richest man in the Philippines. Tan is generally a very reserved, private individual, preferring to stay out of the public eye (ref E). Contacts in the civil aviation sector believe Tan has a great deal of influence over both the Department of Transportation and Communications and the Civil Aeronautics Board.

¶11. (U) John Lance Gokongwei Jr. runs an empire that includes Cebu Pacific Air, the second largest airline in the country, and several real estate, banking, retail, and petrochemicals companies. Lance, a Wharton graduate, received the Philippines Entrepreneur of the Year 2005 award but considers himself risk-averse and conservative. Lance's father built an empire from virtually nothing after World War II (ref E). Cebu Pacific began domestic operations in 1996 and regional flights in 2001. Although the Gokongweis were counted among liberalization advocates in the 1990's, when they sought to build up their airline domestically, they have joined Tan as opponents of E.O. 500B.

Major Players - Advocates of Reform

¶12. (SBU) The loose coalition that supported liberalization around the time of the US-RP air negotiations has re-emerged to support liberalization at Clark. Among active supporters are National Economic Development Authority Secretary Romulo Neri (ref B), Makati Business Club Executive Director Alberto Lim (ref C), the National Competitiveness Summit (a public-private initiative of President Arroyo), the Philippine Chamber of Commerce and Industry, the Clark Development Corporation, local chambers of commerce and government officials, and the coalition of Foreign Chambers of Commerce (including AmCham). Some Chinese Chamber of Commerce chapters, realizing the benefits to their retail and tourism-related businesses from increased tourist arrivals, have parted from the traditionally protective views of other chapters. They have created their own business clubs and publicly support the proposed liberalization.

Our Strategy: Pocket Open Skies

¶13. (SBU) The USG, together with other countries and international organizations, has been involved in promoting liberalization of the civil aviation regime since the 1990s. At present, USAID funds work to support the coalition seeking the signature of E.O. 500B. Post also looks for opportunities to informally advocate more liberal policies with government officials and to build support for liberalization in the private sector and Congress. Over the past few months, we have discussed liberalization of the civil aviation regime at Clark with the Secretaries of Transportation and Communications, Trade, and National Economic Development, with numerous lower officials, businesspeople, and influential, like-minded journalists. Donors joined in support of liberalization at the Philippine Development Forum, where the U.S. played a leadership role, albeit behind the scenes. Post is very careful to keep our support out of the limelight, in order not to detract from

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the effectiveness of the effort.

¶14. (SBU) For Post, and for many of our allies, liberalization of the Clark regime is just one more step in a much larger process. Our expectation is that success at Clark would generate jealousies on the part of other regional centers, such as Davao, in Mindanao, and Cebu, in the Visayas. We would exploit those jealousies to build support for further "pocket open skies" into those airports. Eventually, we would build toward an open national policy, and even an open skies agreement with the U.S.

Comment

¶15. (SBU) Liberalization of the Civil Aviation Regime at Clark is one of Embassy Manila's targets for this year under our MSP goal on Prosperity and Sustainable Growth. We will continue reporting in occasional cables and more frequent updates to the Intellipedia page at http://www.intelink.sgov.gov/wiki/Civil_Aviation_Policy_in_the_Philippines.

KENNEY